

Why Do I Pay A Royalty Fee?



The first point to make about royalties is that good Franchise systems should look at them not as a payment, but rather as a remittance. It is the Franchisor's share of the income derived from customers or clients. The Franchisee collects that fee along with all other revenues from the customer.

It's an important concept because it emphasizes the customer ultimately pays for everything, including the Franchisor's royalty, the Franchisee's overhead, all costs of sales, employee's salaries and the Franchisee's profit. Therefore, it's all about the customer – as it should be.

The Franchisee should want the Franchisor to earn a significant amount of royalties because that's really the oil that makes the engine run. Each Franchisee collects and remits a small portion of that oil to the Franchisor. All elements of the system can continue to improve if the royalty stream is strong.

The Franchisor's royalty will be based on the fact they have provided a system and strategy that has ultimately served the customer. The Franchisee delivers that system to the customer. The royalty represents the Franchisor's share based on the various parts of the Franchise system, which has four elements.

The four elements of a Franchise are:

- a) Brand – the name associated with the services delivered in a memorable and satisfying experience to the customer
- b) Operating System – institutionalizes the excellent service delivered in a memorable experience so it can be repeated from Franchise to Franchise in a consistent manner
- c) Support System – helps the Franchisee improve at delivering the service in a memorable way – helps a Franchisee improve their performance
- d) Franchisee – the individual motivations or reasons for being in a good system, as well as the talents and experience delivered to the business.

The operating and support systems will generally provide access to advice in the fields of marketing, management, advertising, execution of the delivery of the product or service, customer support, etc., all at the level of professional consultants. The cost of these types of consultants on the open market often far exceed the value of the royalty fees remitted by the Franchisee who participates in a system that delivers these items from a position of experience. In fact, it's the exact experience the Franchisee requires, as opposed to open market advice.

Now here's the test. If each of the four elements of a Franchise system are evaluated in terms of the percentage of contribution to the overall success of the business, then the royalty can be assessed in a proper light. Many people will say each of the four elements contributes equally – or 25 percent, to the overall success. That means the brand, operating system and support system provide 75 percent of the success formula. Therefore, as long as the royalty is less than 75 percent, it's a good decision to participate in the system. That's a little silly, but it emphasizes the point.

Most royalties range from 2 percent to 10 percent, depending on the type of system. If the Franchisor's systems contribute 10 percent or more to the success of the business, it makes sense to participate and remit the collection of royalties to the system.

